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ABSTRACT

This report evaluates New York City's methods of managing, upgrading and disposing of the housing it takes for tax arrears. Seven major policy recommendations are offered for handling these in rem properties. The first recommendation suggests that the city develop early intervention strategies in order to stem the flow of distressed properties into the in rem process, and that money be made available to increase the capacity of local groups to take over in rem buildings. Second, timely vesting must proceed in accordance with the provisions of Public Law 45. Third, in rem housing should be made viable by upgrading uniform standards of liviability. Fourth, in rem housing should be weatherized, using Federal and private funds. Fifth, rehabilitation programs must be made responsive to in rem housing problems: in addition, Federal housing policy should become oriented toward rehabilitation and New York State should undertake financing the improvement of distressed housing. Sixth, sales of in rem properties to tenant, community and other nonprofit groups should proceed expeditiously. And seventh, housing and community development programs should include opportunities for economic development and jobs for local residents. (Author/APM)

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REPORT AND RECOMMENDATIONS

OF THE

IN-REM HOUSING TASK FORCE

COMMITTEE ON HOUSING AND URBAN DEVELOPMENT

U.S. DEPARTMENT OF EDUCATION
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The CSS In-Rem Housing Task Force, chaired by Morton Pepper, includes Marjorie Allen, Sandy Bayer, Simon Breines, Antonia Galvez, Emilio Gautier, Bernard Goldstein, Valerie Malcolm, Ralph Marx, Brian Sullivan, Marshall Stukes and Kathryn Wylde.

Terence Benbow
Chairman
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Overview

Today, our entire nation is in the midst of a severe crisis in rental housing. Operating costs are soaring, housing is aging, and tenants' income is not keeping pace with inflation. Owners are caught by insufficient cash flow, returns fall short of expectations, and abandonment follows.

This crisis looms largest in New York City. Our rental housing stock totals 1.9 million units, or 8 per cent of the nation's entire rental supply. Here, some 75 per cent of housing units are in multiple dwellings; in no other city does this figure even reach 50 per cent. Since passage by the City Council of tax arrears legislation (Public Law 45) in 1976, the City has reluctantly become landlord of the last resort. As of May 1980, in rem proceedings have brought into public ownership 12,444 residential properties containing 38,910 occupied units.

Rental housing--and in particular, housing for low-income and moderate-income households--holds little, if any, promise for adequate returns for the private real estate sector. Responding to the hard realities, City government has devised new ways to manage, maintain, upgrade, and dispose of housing it takes for tax arrears. This report evaluates these strategies and proposes policy directions for the future.

During the past few years, the City's energy has focussed mainly on coming to terms with managing the in rem crisis, and significant strides have been made. The Community Service Society believes that the most important task ahead is development of a long-term housing strategy which works toward four main goals:

--- Preservation of housing as an inextricable part of preservation of communities.

--- Maintenance and rehabilitation of existing housing, because it is more cost effective than new construction.

--- Delivery of basic housing services.

--- Establishment of a cooperative partnership of government, communities, lending institutions, and private realtors is needed to keep the City's housing in viable condition.

Where long-term strategy relates to abandoned housing, it should assume that public ownership is a necessary condition. The overall goal of in rem programs should be to lessen the effects of private disinvestment: to stem deterioration, to make feasible improvements, and to expedite return of abandoned buildings to non-public ownership, wherever possible.

The City cannot continue to deal with abandonment only after the fact. Effective steps to stem the flow of tax delinquencies must be taken. The one-year vesting rule set up by Public Law 45 must be followed, for letting abandoned housing lanquish on unpublished tax lists reduces its habitability. We must not fool ourselves into thinking that today's expediencies will not come back as tomorrow's costs--and much greater costs, at that. During fiscal years 1978, 1979, and 1980, some $217 million in Community Development Block Grant funds have been

assigned to deal with the in rem crisis.

The great influx of in rem housing which followed passage of Public Law 45 caught government unaware. Administrators were faced by confusion, and considerable effort went into reorganization of the City's Department of Housing Preservation and Development (HPD). The Department undertook a complete retooling, tapping rehabilitation and related programs which had preceded the in rem crisis.

Of the almost 39,000 occupied residential units in City ownership, HPD reports that 15,205 units are in alternative management programs (DAMP) and the remainder are held and taken care of by the office of in rem property management (DPM). The alternative management programs have 12,490 units in community and tenant-sponsored buildings and 2,715 units in programs involving the private sector.

The City and HPD have shown considerable creativity and have been steadfast in working toward rationalizing government response to the crisis. City management of in rem housing has improved: rent collection has increased, systems repairs are being made and bills are being paid on time. Progress is also being made in reaching other productivity goals.

The alternative management programs work toward transferring viable housing out of public ownership. Numerous management configurations have been devised. These include community management, tenant management, combined private/tenant control, private ownership and management by the Housing Authority.

Last year, for the first time, appropriations for community management decreased by 13 per cent. CSS hopes this is not a sign of faltering commitment of the City.

Tenant involvement is crucial to reviving abandoned housing. In addition, private ownership and management should be encouraged, not in traditional forms, but rather as partnerships with tenants.

Tenants make the crucial difference in bringing a building back to life. Their commitment helps make sure rents are paid on time: in 1980, rent collection in tenant-sponsored buildings was almost 50 per cent higher than in City-managed buildings. Tenants help to bring in new tenants and to save energy and other operating expenses. They work to keep a building safe and clean. But most important, they have a personal stake in the future of their buildings and a personal commitment to their neighborhoods. There is no straighter road to neighborhood stabilization than home ownership.

In rem housing is expensive. Appropriations and tax losses can be counted, but lost hopes, lost opportunities and dismal surroundings cannot

be measured in dollars and cents. In order to lessen the incalculable costs of this enormous problem, CSS offers seven major policy recommendations, as follows:

- Early intervention strategies by the City must be developed to stem the flow of distressed properties into the in rem pipelines. Seed money should be made available to increase the capacity of local groups to take over in rem buildings.
- Timely vesting must proceed in accordance with the provisions in Public Law 45.
- In rem housing should be made viable by upgrading to uniform standards of livability.
- To reduce operating costs, in rem housing should be weatherized, using Federal and private funds wherever possible.
- The current array of rehabilitation financing programs must be made more responsive to the problems in in rem housing. Federal housing policy should become more oriented toward rehabilitation and New York State should undertake financing the improvement of distressed housing.
- Sales of in rem properties to tenant, community and other nonprofit groups should proceed expeditiously.
- Housing and community development programs should include opportunities for economic development and jobs for local residents.

EARLY INTERVENTION

> Early intervention strategies must be devised to stem the flow of distressed properties into the in rem pipeline. Seed money should be made available to increase the capacity of local groups to take over in rem housing.

Though halting abandonment altogether is an unrealistic goal, reducing this phenonmenon can save countless dollars of public funds. Programs for early identification of distressed properties and for effective responses to the problems they face before falling into public ownership must be devised. Simultaneously, the growth of community and tenant groups should be encouraged by providing seed money for organizing purposes.

The City should improve and implement its abandonment potential index as an early warning system to find troubled buildings, owners and tenants. Information for this index should be garnered from tax arrears lists, code violations and utility bill collection records. The system should include information held by government agencies, private utilities, and lending institutions. Such a comprehensive citywide information system can be the quantitative basis for the following early intervention programs.

Counseling. Often troubled properties are owned by small independent companies and families which do not have knowledge of current real estate management and financing techniques. Effective early intervention must, therefore, include a counseling program for present owners and prospective buyers. Training programs and information materials must be provided on how to lessen operating costs, how to

deal with vacancies, how to get money for minor improvements and how to help tenants obtain rent subsidies and other supports services.

Quick Transfer. Three to four years can pass between the time a building first appears on a tax arrears list and the time that City ownership becomes effective. Even before this, several years of disinvestment have taken their toll.

At present, there is no unilateral way for a landlord to give a building away, whether to the City, to a community or a tenant group. A short circuit of the in rem process could have beneficial financial consequences by moving a sounder building sooner to parties able to keep it in good condition.

Under current procedures, tenants are not notified when their landlord ceases to pay taxes. An effective notification system should be devised, so that tenants can petition for a 7A administrator as early as possible, even before in rem proceedings. HPD litigation staff should be increased, as necessary.

Private financial institutions have a crucial stake in in rem proceedings. If an owner, in good faith, informs a mortgagor of impending trouble, the latter can foreclose and move to refinance finance rehabilitation, or find another owner. However, often, banks do not foreclose and pocket losses instead.

Private lenders should be more active and work to transfer foreclosed properties to community and tenant groups. Neighborhood banks

have knowledge of local needs and financial expertise which can be useful in devising local solutions to local problems. Government should play a stronger role in bringing lenders and local groups together to seek innovative ways to keep foreclosed housing from falling into total neglect.

Seed Money. To date, the organization of community groups is the job of unpaid volunteers who give time and money to the larger cause. Community and tenant groups involved in, or looking to be involved in, in rem housing take on a big job--a job that could outstrip their capacities. Only once they are organized do they become eligible for various forms of technical assistance.

Today, a need exists to help groups get started: to take their first steps, become informed on housing programs, obtain government and foundation support and legal and architechtural expertise. In general, they need help in strengthening themselves and becoming viable entities. The City should provide grants as seed money--or start-up funds--to groups which are setting themselves up. The State's Neighborhood Preservation Program which, unfortunately, has not funded any new groups during the past two years, should be expanded and used in tandem with City efforts.

Increasing the Flow of Rehabilitation Funds. At present, two major rehabilitation finance programs are the Participation Loan Program (PLP) which reduces interest rates, and the Article VIIIA program, which provides low-interest loans for buildings housing low-income tenants. Both are effective intervention programs and should receive additional

appropriations. VIIIA eligibility and rehabilitation criteria, which currently exclude buildings most seriously in need, should be amended. Both could be expanded through the use of State funding for the improvement of the more viable *in rem* stock.

TIMELY VESTING

> Timely vesting must proceed in accordance with the provisions in Public Law 45.

Passage of Public Law 45 marked a major change in the City's attempt to deal with abandonment by shortening foreclosure proceedings of tax-delinquent buildings to one year, instead of three. It was believed at the time that by intercepting at an earlier point, sounder buildings would pass into public ownership. Also, it was expected that landlords would pay up sooner rather than lose their property.

Stronger than local legislation in any other city in the nation, Public Law 45 started a great movement--a backlog--of real estate into public ownership, almost overwhelming then-existing government machinery. Since 1976, in rem housing has taken a good portion of CD funds: in 1980 alone, $85.9 million of the $270 million CD budget was allocated for managing in-rem housing.

At present, it appears that a slowing of vesting has begun. This slowdown appears to be a return to a vesting period longer than the one-year period specified in the 1976 Law. The last Bronx vesting was filed on December 5, 1978, and another has yet to be announced. The last Brooklyn list was compiled in January, 1978, and vesting was in the spring and summer of 1979. To date, another list for the borough has not yet been compiled.

This could be shortsighted. In the short run, delays in vesting

ease HPD's workload. But in the long run, abandoned, unvested buildings decay, tenants leave, the block loses another residential structure and the neighborhood suffers a setback. Decay feeds on decay.

Postponed vesting undermines the property tax system. Its double message to landlords is: you have to pay your property tax, but you don't have to pay your property tax. The City's tax collection record seems to bear this out. In Fiscal Year 1976, the last year of three-year vesting, 7.8 per cent of property taxes were uncollected. By Fiscal Year 1980, uncollected taxes were down to 3.7 per cent. But perhaps ominously, the prediction for Fiscal Year 1981 in the Mayor's Budget Message is that the figure will be up to 4.75 per cent.

Slowing down vesting puts buildings in limbo. Without vesting, tenants cannot participate in alternative management programs and have no legal right to manage their buildings. In one Lower East Side building, tenants have waited more than 18 months for the City to take title so they can join a DAMP program. But the most serious result of slowed vesting is that tenants in unvested buildings have no guarantee of basic housing services and the emergency repair program (ERP) cannot respond adequately to all their calls for help.

INSURING BUILDING VIABILITY

> In rem housing should be made viable by upgrading to uniform standards of livability.

Programs to renew the viability of abandoned housing are of prime importance. In rem property must be upgraded to uniform standards wherever feasible, whether it is headed for private hands, public-private partnerships or not-for-profit management.

Most in rem property comes to the City with little potential for self-sufficiency: physical decay abounds and rent rolls are down. Most likely, vacancies had accelerated as disinvestment spiralled. Rent hardly covered operating costs and, even in fully occupied buildings, could not be raised to levels that would cover expenses.

Reversing this phenomenon can begin only with basic physical rehabilitation. Rehabilitation will attract new tenants and prevent further moveouts, thereby stabilizing cash flow. It will also reduce operating outlays, a factor of particular import to community and tenant groups which undertake management and ownership. These groups have limited financial means, and stand a better chance with a sounder building. Without appropriate rehabilitation, the City stands a bigger chance of getting a building back in another in rem proceeding.

Of course, the question is where is the rehabilitation money to come from. The total is sizeable: it has been estimated that even the soundest Tenant Interim Lease (TIL) buildings require $2,500/d.u. for

basic systems. Getting all the funds needed will be a difficult task, one that requires full commitment and hard choices. Government, community and tenant associations and lending institutions must join in creative partnerships to stabilize our deteriorating rental housing.

Though no building should be sold without dealing with these fundamental considerations, it is unrealistic to conclude that all in rem housing can or should be rehabilitated using public money. Opportunities may exist to encourage groups and individuals to purchase unrehabilitated buildings. Incentives could take the form of lower rents or property tax abatement.

WEATHERIZATION

> To reduce operating costs, in rem housing should be weatherized, using Federal and private funds wherever possible.

Central to a strategy for reducing operating costs is the need for energy efficiency and conservation. Fuel costs are skyrocketing. Where it cost $4.50 to heat a one-bedroom apartment in 1968, the bill had risen to $70.00 by 1978. Today, fuel and utilities are 30 to 50 per cent of total expenses.

Solace can be found, however, in two facts: significant savings can be realized through energy audits, tenant education, conservation and weatherization. Moreover, improvements can be self-amortizing, or paid for out of savings.

The major source of energy-related funds, the Federal weatherization program, is not designed for full-scale assistance to multiple dwellings. Federal and State allocation formulas are biased against multi-family buildings. Tenant income restraints and elaborate individual certification requirements restrict the number of multiple dwellings that qualify. Regulations exclude hallways and other common areas from eligibility. These regulatory restraints not only limit the City's total allocation but also minimize the City's ability to spend what funds are appropriated. This program could become more useful if weatherization funds were allocated to classes of property such as City-owned, nonprofit and property in CD-eligible areas, and if income

restraints were waived. HPD is working toward these goals.

The Federal Solar and Energy Conservation Bank, set up last year, can also be a source of weatherization funds, providing below-market rate loans of up to $10,000. Its total appropriation for Fiscal Year 1981--$125 million--however, indicates that it can play only a limited role at this time.

The City should seek ways to involve other Federal programs in fostering the growth of community-based weatherization companies. CETA, Economic Development Administration, Small Business Administeration, and National Consumer Coop Bank can all help community-based organizations in small scale enterprises that provide skills and jobs for local residents.

To further increase funds available for weatherproofing, the City should encourage participation by private lenders. Joint ventures could be prudent self-amortizing investments for the private sector.

REHABILITATION FINANCE

> The current array of rehabilitation financing programs must be made more responsive to the problems of *in rem* housing. Federal housing policy should become more oriented toward rehabilitation, and New York State should undertake financing the improvement of distressed housing.

Federal housing policy has traditionally not focussed on the problems of rental housing. What few relatively minor rehabilitation programs exist today attempt to solve new problems with old tools. Inflation and escalating fuel costs are taking their toll. More and more housing in cities across the nation is being lost to abandonment and arson. The cost of new construction is soaring. For these reasons, the need to turn the direction of Federal policy toward saving existing housing should loom large on the agenda of the new administration.

Rehabilitation, though increasingly expensive, costs considerably less, uses less energy and provides more jobs than new construction. It seems prudent, therefore, for the Federal Government to begin developing housing preservation programs designed to meet the problems of the 1980s--inflation, energy, abandonment and arson. A more balanced tax policy which treats homeowners and renters equitably should follow. Property tax deductions, such as passed by the State Legislature in 1978 but disallowed by the Federal Internal Revenue Service, should be given thorough consideration.

At present, the Federal programs which related to rehabilitation are not up to the task. The array of programs is a patchwork and funding

levels are low. Basically, they fall into three categories: insurance, direct loans and subsidies.

Insurance. In general, the insurance programs have limited applicability in the City because of stringent design standards, delays in processing and limited authorization. Section 223(f), recently reorganized specifically for housing preservation, holds promise for in rem structures because buildings can receive this support even if they do not meet HUD's more stringent eligibility standards. The City's large stock of five-story walk-ups may now stand a chance of Federally-insured rehabilitation loans.

Title I Property Improvement Loans Guarantees, used mainly for single family homes, have potential for use in rehabilitation of smaller multiple-dwellings. State housing finance agencies can also participate. Lenders handle all processing themselves, reducing costly time delays considerably.

Section 203(k), which insures rehabilitation loans, was extended in 1978 to include acquisition and refinancing of property slated for rehabilitation. This program is designed for one- to four-family homes.

Section 221(d)(3), which offers 100 per cent insurance for private nonprofit and public mortgages, and (d)(4) which has a 10 per cent equity requirement and applies to all mortgages are HUD's primary programs for substanital rehabilitation of buildings with five or more units. Their applicability to New York City is checked by requirements that rehabilitated

buildings meet HUD's minimum design standards.

Direct Loans. Section 312 Rehabilitation Loans provide low-interest long-term financing provided to building owners in low and moderate-income neighborhoods. Designed specifically for housing preservation, Section 312 funding levels do not meet the overall need.

The National Consumer Coop Bank, created in 1978, can become an important vehicle for rehabilitation. The bank can buy mortgages originated by private lenders, thereby easing lender's reluctance to finance housing purchases by tenant cooperatives. It can also originate mortgages and sell them on the secondary market. The Bank's Office of Self-Help Development will also assist low-income cooperatives which cannot qualify for regular mortgages.

Subsidies. The Section 8 rehabilitation programs provide rent supplements and assure an even flow of income to landlords seeking rehabilitation loans in the private sector. The program has proved to be problemmatic. Most in rem buildings fall short of HUD's minimum property standards. HPD's promise to use these subsidies in the Community Management Program may prove unrealizable. HUD's past experiences with community-based co-operatives has not been successful. To bring interest costs down, local groups need GNMA tandem financing, which is not only in short supply but also very complex. Perhaps Section 8's most serious problem is that it provides no incentive to keep costs down. Currently, they are running at $55,000 per unit for substantial rehabilitation; only $35,000 of which is for construction, and $30,000 per unit for moderate

improvements.

The Role of New York State. Because abandonment also occurs in Buffalo, Rochester and Albany and in many upstate counties, devising a long-range strategy to lessen the City's burden in caring for in rem housing should start with exploring a role for the State. At present, the State has no programs for rehabilitating distressed housing and has contributed little in local assistance in recent years.

Recently, other states have been using their bonding authority for aid for single-family dwellings. Such authority might also be used to provide rehabilitation loans for the more viable of the City's troubled and in rem housing.

Municipalities can not bear the in rem burden alone. The State must recognize its responsibility and develop plans which strengthen local governments' attempts to stabilize housing. It has yet to use tax-exempt financing for such purposes. State bonds could be issued by the State Housing Finance Agency and revenues could be allocated to expand the Participation Loan and Article VIIIA programs. To make the bonds more marketable, insurance mechanisms such as FHA Section 223(f) and Real Estate Mortgage Insurance Corporation (REMIC) could be used. The State should also expand the use of SONYMA to insure multi-family structures. A CD fund to guarantee State bonds should be used if necessary.

Continued State uninvolvement could jeopardize the City's case in using CD funds for in rem purposes--an argument made during the

fiscal crisis. State participation would free CD money now being used for PLP and VIIIA for a similar program which would be designed specifically for less viable buildings.

The City's Role. It is unrealistic to expect additional rehabilitation funding to come from the City. In the current fiscal situation, the City cannot afford to use tax levy funds to support rehabilitation of in rem housing. However, there are two actions the City should consider.

The Housing Preservation and Development Department should amend its current practice and allow Section 312 loans to larger buildings, as is specified in Federal regulations.

HPD has been drawing away from its commitment to sweat equity rehabilitation, citing experiences that were too costly and burdens that were too heavy for the homesteaders. CD VI funds were cut to $200,000 from the $2 million allocated for the previous year. Rather than pulling away, HPD should expand on a recent experiment in which it provided basic systems to match the homesteaders responsibility for competing rehabilitation. HPD's commitment of $4,000/unit leveraged total rehabilitation for $10,000/unit--a low cost in today's market. This and other ways to develop workable cost-effective sweat equity projects need further exploration.

SALES POLICY

> Sales of in rem properties to tenant, community and other nonprofit groups should proceed expeditiously.

In 1979, the Board of Estimate established a policy to guide sales of in rem housing to community and tenant groups. In CD-eligible areas, sales to Article XI nonprofit housing corporations are generally priced at $250 per dwelling unit. The commissioner of the Department of Housing Preservation and Development can recommend a higher price if an adequate reason exists. In practice, an adequate reason has been interpreted as potential for neighborhood upgrading and rising real estate values and HPD is not selling in high-potential areas. This has been creating uncertainties among community and tenant groups.

A case can be made for adherence to a uniform citywide sales price. Uniform policy would dispel residents' fears, help the City avoid a role as speculator and facilitate economic integration of neighborhoods. Most significantly, it would insure that neighborhood upgrading accrues to long-term residents. It should also be City policy that, for ten years after sale by the city, to return to the in-rem budget any profits gained in future sales of former in rem buildings by tenant co-operatives, private owners and other entities.

In addition, options other than sales should be studied. Long-term leases to current residents could help stabilize the neighborhoods, and also be used in other neighborhoods where sales cannot be effectuated.

The legal process of forming a tenant cooperative and establishing the terms of sale is complex and time consuming. To date, some progress

has been made to simplify the tenants' prospectus and make it more comprehensible. A Spanish version remains to be developed.

Buildings being sold to tenants should carry low-interest purchase money mortgages, the same as offered with buildings sold at auction.

Post Sales Policy. Success in sales should not be the primary measure for evaluating DAMP effectiveness. To date, the City has sold five buildings with 32 units. As more in rem housing moves toward the end of the pipeline, development of a sound after-sales policy becomes significant. The following elements should be considered for inclusion:

--- HPD and the prospective tenant owners should meet before the sale to establish a five-year building management plan.

--- HPD's after-sales fund for tenant cooperatives should be increased as more buildings are sold. These funds should be applicable for needed capital expenditures as well as emergency situations in post-sales buildings. If these funds are to be used for only emergency situations, specific Article VIIIA funds should be set aside for these buildings to finance needed, but non-emergency capital needs.

--- Technical assistance should be provided as needed.

--- Continued growth of self-help cooperative networks should be encouraged to share expertise, realize cost savings through bulk purchases and share in other mutually reinforcing activities.

The question of property tax assessment of buildings sold to local cooperatives is pivotal. At present, tenant cooperatives are not responsible for tax arrears, but start paying full tax at the same rate as the previous owner. Though it is crucial for the City to fill out its tax rolls, care should be taken so that taxes do not overburden local groups. The ingredients of market value and assessed value in this induced market

should be analyzed. Nonprofit tenant cooperatives should be allowed to make payments in lieu of taxes as a per cent of shelter rents, similar to provisions in the limited-profit Mitchell-Lama housing program. Property tax legislation should be amended to create a separate tax classification or status for nonprofit groups.

ECONOMIC DEVELOPMENT

Housing and community development programs should include opportunities for economic development and jobs for local residents.

Upgrading of in rem housing provides opportunities for growth of a locally-based and controlled housing-services industry which offers jobs to local residents. The relationship of housing programs to renewing local economic strength is inextricable, and can proceed without pressuring the City's budget by using Federal economic development funds.

The need to create economic development plans for neighborhoods impacted by the in rem problem is crucial. These plans should tap local entrepreneurial potential as it relates to housing improvements, and should have three major elements, as follows:

--- The City should encourage growth of existing local efforts and creation of new enterprises. These could be contractors, building services providers and equipment suppliers, working through local or community development companies.

--- Technical assistance needed to put these groups into operation should be provided. Help could be proferred in incorporation, identifying local markets, identifying government and private loans sources, preparing loan applications, tax counseling and other red-tape cutting.

--- Housing rehabilitation calls for skills that can be learned in on-the-job situations. The City should also work with local businesses and residents to create jobs that tap the local labor force in non-housing areas.